

# SDM: Case Report SKN Caribecafé

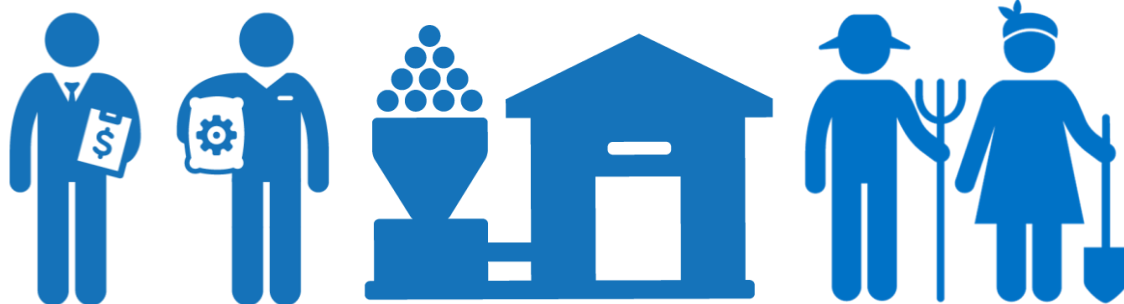
Service Delivery Model assessment: short version

August 2019

Location: Colombia

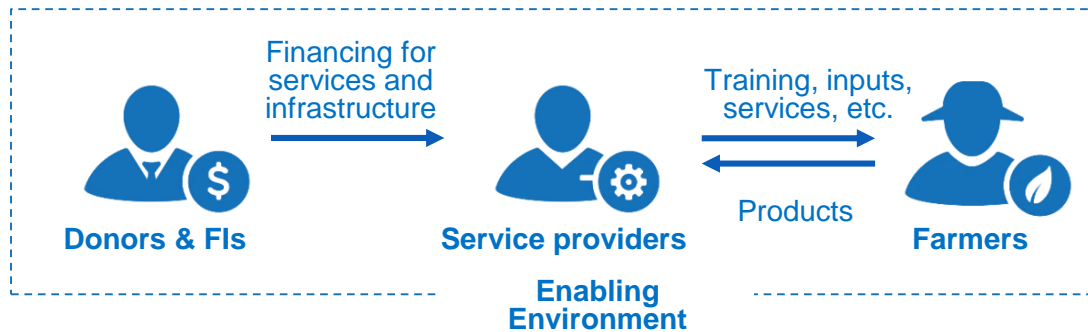
Commodity: Coffee

Services: Extension, financial, certification and compliance, information services, market access



# What are SDMs and why are we interested in analyzing them?

**Service Delivery Models (SDMs)** are supply chain structures, which provide services such as training, access to inputs and finance to farmers, to improve their performance, and ultimately their profitability and livelihoods.



By analyzing SDMs, we aim to support **efficient, cost-effective and economically sustainable SDMs at scale** through:

Key drivers for success of SDMs benchmarking



Innovation opportunities to support



Cross-sector learning, learning community



Convening at sector and national level



## Analyzing SDMs brings a range of benefits



### Farmers and farmer organizations

- **Better services** improve productivity, product quality, quality of life and social and environmental outcomes
- **Better outcomes:** improved productivity, income and resilience



### SDM operator

- **Understand** your model's business case
- Gain insights to **improve** service delivery
- Develop **cost-effective** SDMs based on insights
- Identify opportunities for **innovation** and **access to finance**
- **Learn** from other public and private SDM operators operating across sectors/geographies
- **Communicate** stories of impact and success at farmer level



### Investors/FIs

- **Common language** to make better informed investment decisions
- Insights to achieve optimal **impact, efficiency and sustainability** with investments and partnerships in SDMs

# The SKN Caribecafé SDM and objectives

## General SDM information:

Location:	Colombia
Timing in analysis scope:	2017-2025
Scale (start of analysis):	3,704 farmers
Scale (end of analysis):	10,350 farmers
Funding:	Service provider, Nespresso, Neumann Gruppe, USAID, Rabobank, ABN AMRO, IDH
SDM Archetype*:	Global



SKN was founded in 1945 in Tolima by Lord Schaefer, Klausmann and Neumann.

Caribecafé started in 1956 in Medellin by Lord John Kalf and Gunter Lemberg.

In 1997 the companies were merged to form SKN Caribecafé. The Nuemann Kaffee Gruppe became the majority shareholder. The direct access to farmers and high-quality Arabica beans were the rationale for the acquisition.

In 2007 SKN Caribecafé started a partnership with Nespresso to source AAA quality coffee, that buys directly from farmers through their 10 buying stations.

## SDM objectives:

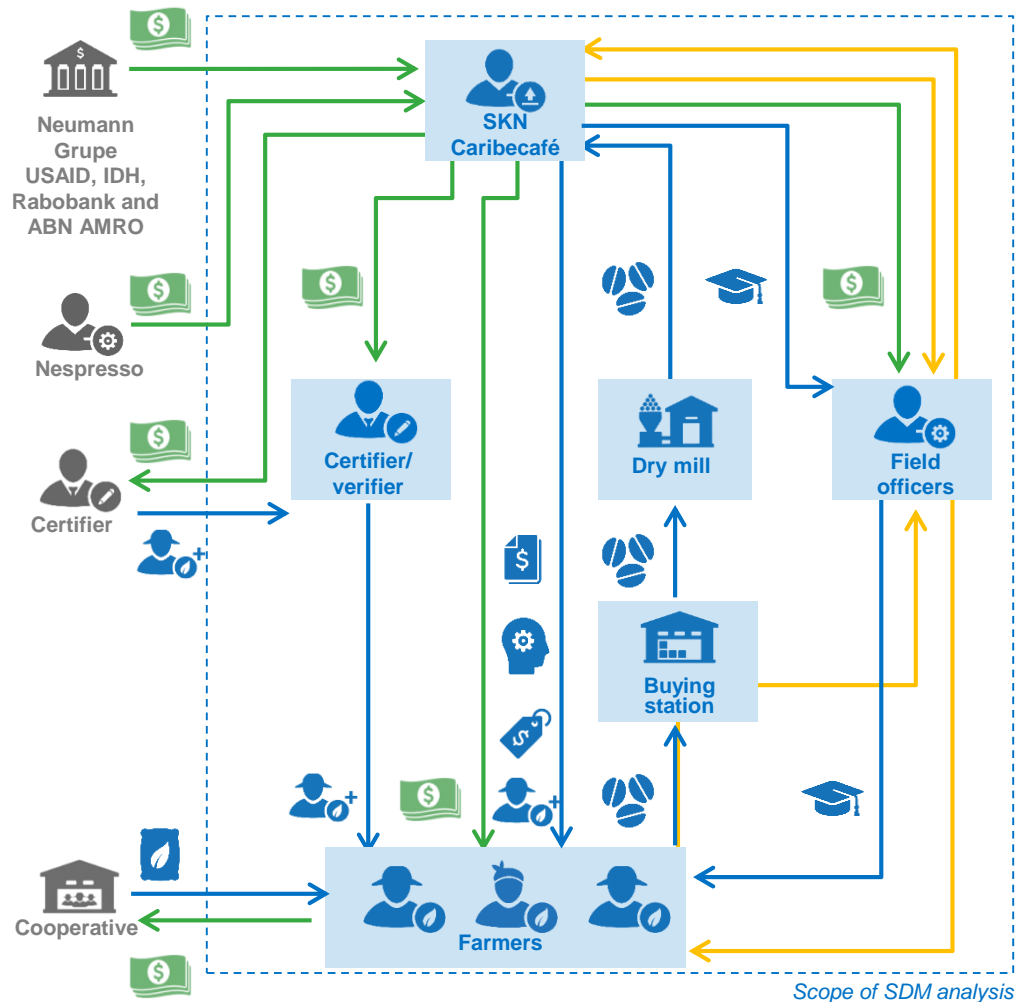
- 1 Strengthen SKN supply chain
- 2 Enable farmers to realize their full potential via the provision of services
- 3 Establish a sustainable Farmer Service Unit that offers commercially viable services to farmers
- 4 Improve access to high quality coffee, increasing income for producers and value chain actors

## SDM rationale:



\* For more info on SDM archetypes, see the [IDH Smallholder Engagement Report](#)

# SDM and structure and enabling environment



## Enabling environment

Farmers are impacted by several factors within their enabling environment. Most important are:

### 1. Trading system

Coops (often managed by FNC) are the normal market outlet where producers can sell their coffee at a transparent price that is in line with current international market prices and receive cash payment for their coffee.

### 2. Inputs & Financing

Due to high default risks and information asymmetries, access to finance is too complex for farmers. Often, farmers in need for access to working capital, sell wet parchment to middleman at a lower cost, decreasing the potential profits on their produce. There is the need for guarantors or other structures that facilitate access to finance.

### 3. Price & Competitiveness

Coffee prices are highly volatile following the international market price. Between 2008 and 2017, prices to growers varied by over 100%. Moreover, recent global surpluses have put further downward pressure on price.

# Services delivered and farmer segmentation

## Extension services

- Field officers provide farmers with agronomic advice, information on pricing, as well as coffee management practices.
- Field officer visit each farmer at least once per year.
- SKN monitors farmers closely, in order to provide them with the adequate support to resolve problems.
- Nespresso contributes to finance the cost of capacity building, so farmers are able to improve the quality.

## Financial services\*

- Digital payments that facilitate access to other financial services.
- Short-term finance for working capital, such as input purchase or investment in labor.
- Long-term financing for assets such as machinery, or for farmer groups to establish their own wet mills.
- (under development) Nanocredits via mobile banking, to avoid the challenges of access to cash



## Certification and compliance

- Offered through the extension services.
- Farmers are supported to comply with diverse schemes, such as Nespresso's AAA scheme, Starbucks Coffee Practices or Rainforest Alliance.
- Certification will result in a premium paid to farmers.



## Information services\*

- Provision of Field Buzz mobile app and a card to farmers, in order to digitalize all transactions, and to manage their farms.
- This decreases human error in the transactions, ensure traceability for buyers and to keep track record.



## Market access\*

- SKN will provide access to a global network of customers that demand top quality Colombian coffee.
- Farmers will be able to sell their specialty coffee at competitive prices, positioning SKN as a premium buyer.

## Farmers are segmented in this SDM:

This SDM model differentiates between three farmer profiles, based on their loyalty towards SKN and the quality of the coffee that they produce. These segments will allow better service delivery by SKN Caribecafé. The delivery suits each segment's needs and capabilities. The three segments are:

### Opportunity suppliers

- Baseline productivity: 875 kg/ha
- Loyalty rates: 20%-30%
- Quality: commercial grade, standard

### Service adopters

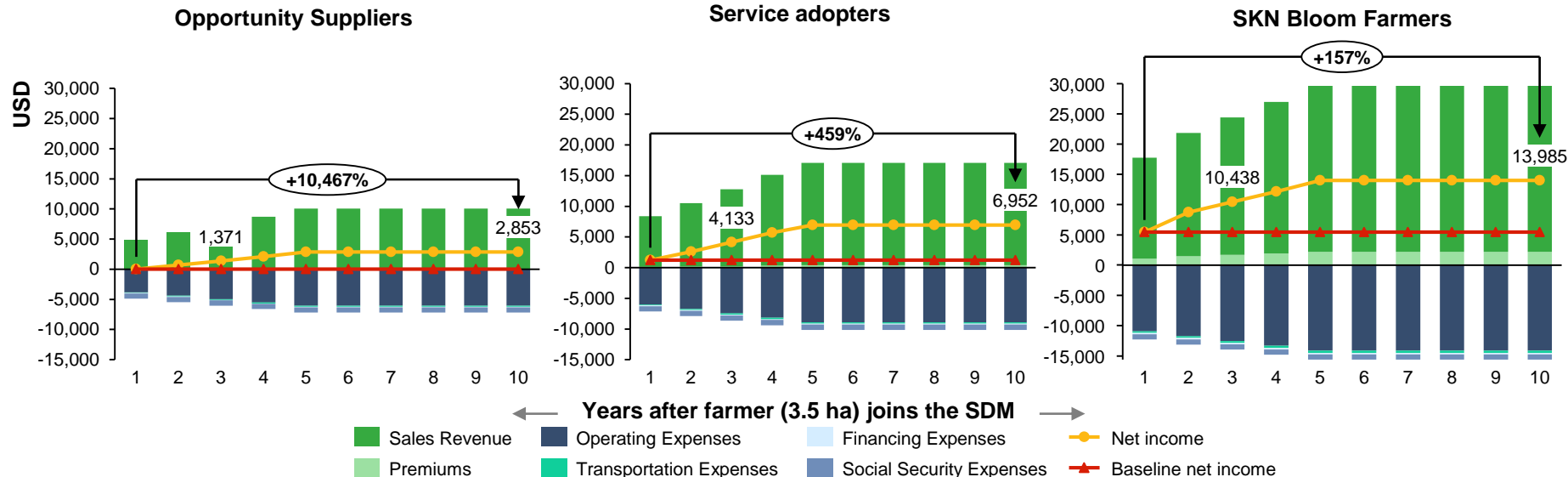
- Baseline productivity: 1,375 kg/ha
- Loyalty rates: 40%-50%
- Quality: mid and high quality

### SKN Bloom farmers

- Baseline productivity: 2,500 kg/ha
- Loyalty rates: 60% or more
- Quality: high and top quality (specialty), but also standard quality

\* Services under development that will be offered from 2020 onwards

# Overall SDM impact: Farmer P&L



## Economic sustainability at farm level

All SDM farmers are more resilient than baseline farmers. Being the SKN Bloom farmers who present the most improvement; farmers of this segment that participate in the SDM earn more than 2.5 times as much as farmers that produce similar quality and that are not part of the SDM. Opportunity suppliers (segment 1) double their production during the SDM and can capitalize on increasing yields, as a result of improving their practices. Service adopters (segment 2) end up selling significantly less of their product to other actors resulting in higher incomes, and improved access to farmers. Likewise, SKN Bloom farmers end up selling significantly less of their product to other buyers resulting in higher incomes and reducing the pressure to sell wet parchment to have access to working capital, as they benefit from financial services provided by SKN.

Farmers of the segments 1 and 2 (opportunity suppliers and service adopters) are still at risk if labor prices rise, or if the amount of product required by the FNC increases, reducing their profit as the coffee is sold at lower prices compared to SKN or other private buyers. SKN Bloom farmers have significant income, and therefore are able to invest in their operations.

## Main revenue drivers

- **Production:** Reliance on increasing productivity. The other main contributing factor here is a strong relationship with the purchasing entity, ensuring an offtaker for the increased production.
- **Quality:** Opportunity suppliers receive no price premium. Service adopters and SKN Bloom Farmers have premiums of less than 3% and 8% of total revenue, respectively.

## Main cost drivers

- **Labor:** The largest cost driver, it makes up more than 50% of total costs, with the highest labor costs resulting from harvesting and fertilizing.
- **Social Security:** Since these farmers exceed the maximum threshold for social provisions, the family is required to pay 864 USD per year for social programs provided by the government.

# Specific service impact: sensitivity analyses

## Market volatility impact

Coffee prices are extremely volatile in general, and Colombian mild are no exception. Month to month price fluctuations can be in the double-digit percentages, and between 2011 and 2013 there was a 60% price-per-kg drop. Prices are currently low, and with a global surplus expected for the near future, they could continue to drop further. According to ICO, 2019 average prices are down to 1.19-1.25 USD/Kg, from mid-1.3-1.43 USD/Kg in 2018. Prices are currently stagnant, but other varieties (Robusta and other Milds) are seeing their prices fall further.

Colombian Mild monthly ICO price index (USD/KG)



\*Announcement by Ivan Duque of a minimum wage of 253 USD/month CNN (2018). In which Latin American Country do you earn the best?  
Sources: ICO (2018). ICO Monthly Composite Price

## Sensitivity of farmer income

Farmer annual income for varying coffee prices and yields

		Yield (kg/Ha)					
		750	1750	2750	3750	4750	5750
Farm-gate price (USD/kg)	1.5	1125	2625	4125	5625	7125	8625
	1.8	1350	3150	4950	6750	8550	10350
	2.1	1575	3675	5775	7875	9975	12075
	2.4	1800	4200	6600	9000	11400	13800
	2.7	2025	4725	7425	10125	12825	15525

Opportunity suppliers

Service adopters

SKN Bloom farmers

Below poverty line\*

SKN Bloom farmers, in the current situation, perform quite well. They have coffee revenues of 7,875 USD per ha, and with prices at very low levels, these farmers are able to remain with a viable business case. However, “Service adopters” and “Opportunity suppliers” are in a more tenuous position, with “Opportunity suppliers” nearly at the minimum wage point. Prices are near decade lows, yet, there is not optimism this will end soon. That being said, the FNC subsidizes farmers if they earn below production costs (currently estimated at COP 700,000 per carga or 1.7 USD/kg). Farmers are beginning to seek alternative income sources, such as avocado, but in the near term many farmers will struggle to make a sustainable profit and may be operating at a net loss.

# SDM outcomes and main learning questions

*These are not an official assessment of SDM success or failure by IDH or NewForesight, but an indication based only on the analysis done in this forward-looking study, and on assumptions provided by the case owner(s). Actual assessment of success of the SDM should be conducted during and after the SDM is conducted using measured results*

SDM objectives	Projected outcomes
<p><b>1 Strengthen SKN supply chain</b></p>	<ul style="list-style-type: none"> <li>• Farmers will improve management practices, become more professional, and improve their livelihoods.</li> <li>• SKN will improve farmer loyalty, the sustainability of the SDM, and strengthen their relationship with the supply base.</li> </ul>
<p><b>2 Enable farmers to realize their full potential via the provision of services</b></p>	<ul style="list-style-type: none"> <li>• Farmers will increase their productivity, income, quality of the bean. Consequently, their livelihoods and their families will improve, as their business case improves.</li> <li>• SKN increase sourcing from the farmer base, improve quality, and leverage on improvements at farm level for product differentiation.</li> </ul>
<p><b>3 Establish a sustainable Farmer Service Unit that offers commercially viable services to farmers</b></p>	<ul style="list-style-type: none"> <li>• Farmers will have timely access to high quality services, as well as access to financial services, improving their asset holding and income resilience.</li> <li>• SKN will enable commercial feasibility of the SDM, as farmers become more professional and ensure sustainable demand for these services.</li> </ul>
<p><b>4 Improve access to high quality coffee, increasing income for producers and value chain actors</b></p>	<ul style="list-style-type: none"> <li>• Farmers will receive a higher farmgate price and increase their income.</li> <li>• SKN will increase farmer loyalty and strengthen commercial ties with farmers in the supply chain.</li> <li>• Both will increase their income resilience due to a wider variety of products offered.</li> </ul>

Learning question	SDM insights
<p>What do the farmers need in order to shift from conventional coffee to high/top quality coffee?</p>	<p>Farmers need training and assistance (on an ad-hoc basis) to enable the shift to high and top-quality coffee. The extension officers will provide these services, using the information service tools to monitor the progress. Furthermore, farmers need access to working capital and long-term loans to invest in their farms.</p>
<p>How will this affect the business model for the farmer?</p>	<p>Farmers that shift to higher quality coffee see greater price premiums and a more stable income as they shift away from selling standard quality and wet parchment. This also would mean that SKN acts as their market agent for top quality lots.</p>
<p>How will the farmers be organized to best deliver services?</p>	<p>Farmer act as individuals, but they are profiled into three segments based on their relationship with SKN. <b>SKN Bloom farmers</b> are the most loyal and deliver the highest quality, <b>service adopters</b> slightly less loyalty with high quality and <b>opportunity suppliers</b> as the least loyalty and lowest quality.</p>



# Key insights



## Key drivers of success

- Focused on needs-based approach. The services are delivered to the farmers that most need them and that have the potential to benefit from them.
- Farmers within the SDM are highly professionalized, having their own washing stations and able to afford value-add steps.
- Focus on quality due to the ability for SKN to source additional high-quality product.
- Customer-oriented mindset when working with farmers, rather than view them only as suppliers of coffee.



## Key factors in replication

- industries such as coffee require a differentiation strategy to capture back their investment. Focus on quality to ensure value capture is important.
- Being competitive in the service delivery space is key. not competing on input provision or working with others to provide financial solutions.
- Treating farmers as partners and tailoring services to their needs is much more successful than creating a package that might not have a sustainable demand.



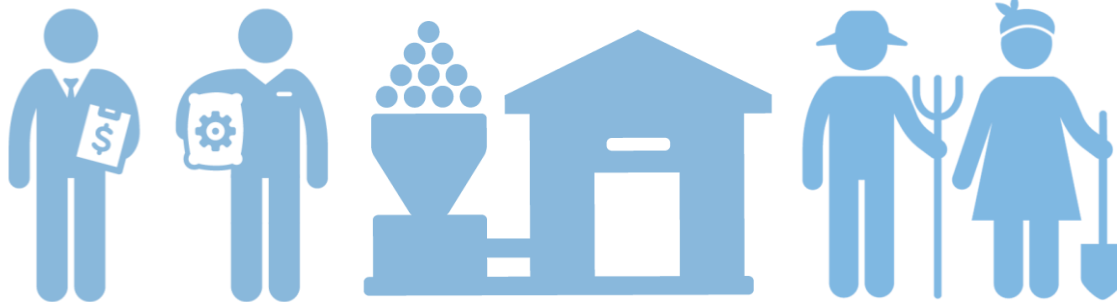
## Key risks

- Due to its small scale, the SDM does not generate enough additional sourcing or revenue to cover its costs of operation.
- If price margins are reduced due to fluctuations, the SDM will cease to be viable.
- Taxations and changes in policy that negatively impact on the price of producers would threaten the feasibility of the SDM.
- Managing other actors in the context, as coops, is highly relevant. Their presence in many areas provides a space to create synergies, as they are strong service providers for inputs and other complementary service that benefit the farmers.



## Opportunities for improvement

- As services will be provided based on the farmer segmentation, it might be good to consider other characteristics than loyalty to ensure farmers are ready for a successful service adoption.
- To improve the transaction throughput time by improving efficiency will allow not only to do more transactions, but it is also a competitive advantage.
- Training and services are largely done on an ad hoc and individual basis. This can be improved by having a structured approach.
- New farmer programs should focus in more incentives than only price and reward farmer loyalty and service adoption. Consequently, bean access and quality could improve.



For more information and insights on SDM's, see the [IDH Smallholder Engagement Report](#)